

Public Service Commission of Wisconsin
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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS - (Cont'd) 2013 Form 10-K

Each of these facilities has a renewal provision for two one-year extensions, subject to lender approval.

The following table shows our capitalization structure as of December 31, 2013 and 2012, as well as an adjusted capitalization structure that we believe is consistent with the manner in which the rating agencies currently view Wisconsin Energy's 2007 Series A Junior Subordinated Notes due 2067 (Junior Notes):

Capitalization Structure	2013		2012	
	Actual	Adjusted	Actual	Adjusted
(Millions of Dollars)				
Common Equity	\$ 4,233.0	\$ 4,483.0	\$ 4,135.1	\$ 4,385.1
Preferred Stock of Subsidiary	30.4	30.4	30.4	30.4
Long-Term Debt (including current maturities)	4,705.4	4,455.4	4,885.9	4,815.9
Short-Term Debt	537.4	537.4	394.6	394.6
Total Capitalization	<u>\$ 9,506.2</u>	<u>\$ 9,506.2</u>	<u>\$ 9,426.0</u>	<u>\$ 9,426.0</u>
Total Debt	\$ 5,242.8	\$ 4,992.8	\$ 5,280.5	\$ 5,010.5
Ratio of Debt to Total Capitalization	55.2%	52.5%	55.8%	53.2%

For a summary of the interest rate, maturity and amount outstanding of each series of our long-term debt on a consolidated basis, see the Consolidated Statements of Capitalization.

Included in Long-Term Debt on our Consolidated Balance Sheets as of December 31, 2013 and 2012 is \$500 million aggregate principal amount of the Junior Notes. The adjusted presentation attributes \$250 million of the Junior Notes to Common Equity and \$250 million to Long-Term Debt. We believe this presentation is consistent with the 50% or greater equity credit the majority of rating agencies currently attribute to the Junior Notes.

The adjusted presentation of our consolidated capitalization structure is presented as a complement to our capitalization structure presented in accordance with GAAP. Management evaluates and manages Wisconsin Energy's capitalization structure, including its total debt to total capitalization ratio, using the GAAP calculation as adjusted by the rating agency treatment of the Junior Notes. Therefore, we believe the non-GAAP adjusted presentation reflecting this treatment is useful and relevant to investors in understanding how management and the rating agencies evaluate our capitalization structure.

As described in Note H -- Common Equity, in the Notes to Consolidated Financial Statements, certain restrictions exist on the ability of our subsidiaries to transfer funds to us. We do not expect these restrictions to have any material effect on our operations or ability to meet our cash obligations.

Wisconsin Electric is the obligor under two series of tax exempt pollution control refunding bonds in outstanding principal amounts of \$147 million. In August 2009, Wisconsin Electric terminated letters of credit that provided credit and liquidity support for the bonds, which resulted in a mandatory tender of the bonds. Wisconsin Electric issued commercial paper to fund the purchase of the bonds. As of December 31, 2013, the repurchased bonds were still outstanding, but were not reported as long-term debt because they are held by Wisconsin Electric. Depending on market conditions and other factors, Wisconsin Electric may change the method used to determine the interest rate on the bonds and have them remarketed to third parties.

On December 5, 2013, the Board of Directors reviewed management's plan to maintain an appropriate capital structure by retiring up to \$500 million of the holding company's obligations during the period 2014 through 2017.

Bonus Depreciation Provisions

The American Taxpayer Relief Act of 2012 was signed into law on January 2, 2013, which extended the 50% bonus depreciation rules to include assets placed in service in 2013. These rules apply to the biomass plant we constructed in Rothschild, which went into service in November 2013. As a result of the increased federal tax

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depreciation for 2013 and prior years, we did not make federal income tax payments for 2013 and do not anticipate making federal income tax payments for 2014.

Credit Rating Risk

We do not have any credit agreements that would require material changes in payment schedules or terminations as a result of a credit rating downgrade. We do have certain agreements in the form of commodity contracts and employee benefit plans that could require collateral or a termination payment in the event of a credit rating change to below BBB- at Standard & Poor's Ratings Services (S&P) and/or Baa3 at Moody's Investor Service (Moody's). As of December 31, 2013, we estimate that the collateral or the termination payments required under these agreements totaled approximately \$214.6 million. Generally, collateral may be provided by a Wisconsin Energy guaranty, letter of credit or cash. We also have other commodity contracts that in the event of a credit rating downgrade could result in a reduction of our unsecured credit granted by counterparties.

In addition, access to capital markets at a reasonable cost is determined in large part by credit quality. Any credit ratings downgrade could impact our ability to access capital markets.

In January 2014, Moody's raised the ratings of Wisconsin Energy (senior unsecured to A2 from A3; junior subordinated to A3 from Baa1; commercial paper to P-1 from P-2), Wisconsin Electric (senior unsecured to A1 from A2), Wisconsin Gas (senior unsecured to A1 from A2), Elm Road Generating Station Supercritical, LLC (ERGSS) (senior notes to A1 from A2) and Wisconsin Energy Capital Corporation (WECC) (senior unsecured to A2 from A3). The commercial paper ratings of Wisconsin Electric and Wisconsin Gas remained at P-1. Moody's assigned a stable ratings outlook to each company.

In December 2013, S&P raised the ratings of Wisconsin Gas commercial paper to A-1 from A-2, and senior unsecured to A from A-. S&P also affirmed the stable rating outlook.

In June 2013, S&P affirmed the ratings of Wisconsin Energy (commercial paper, A-2; senior unsecured, BBB+; junior subordinated, BBB), Wisconsin Electric (commercial paper, A-2; senior unsecured, A-), Wisconsin Gas (commercial paper, A-2; senior unsecured, A-), WECC (senior unsecured, A-) and ERGSS (senior notes, A-). S&P also revised the ratings outlooks assigned to each company from positive to stable.

In June 2013, Fitch Ratings (Fitch) affirmed the ratings of Wisconsin Energy (commercial paper, F2; senior unsecured, A-; junior subordinated, BBB), Wisconsin Electric (commercial paper, F1; senior unsecured, A+), Wisconsin Gas (commercial paper, F1), WECC (senior unsecured, A-) and ERGSS (senior notes, A+). At the same time, Fitch lowered the senior unsecured rating of Wisconsin Gas to A from A+. Fitch also affirmed the stable ratings outlooks assigned to each company.

Subject to other factors affecting the credit markets as a whole, we believe our current ratings should provide a significant degree of flexibility in obtaining funds on competitive terms. However, these security ratings reflect the views of the rating agencies only. An explanation of the significance of these ratings may be obtained from each rating agency. Such ratings are not a recommendation to buy, sell or hold securities. Any rating can be revised upward or downward or withdrawn at any time by a rating agency.

Capital Requirements

Capital Expenditures: Our estimated capital expenditures for the next three years are as follows:

Capital Expenditures	2014	2015	2016
	(Millions of Dollars)		
Utility	\$ 667.9	\$ 777.6	\$ 587.6
We Power	38.6	19.8	28.7
Other	4.5	6.8	5.5
Total	<u>\$ 711.0</u>	<u>\$ 804.2</u>	<u>\$ 621.8</u>

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The majority of spending consists of upgrading our electric and gas distribution systems. Our actual future long-term capital requirements may vary from these estimates because of changing environmental and other regulations such as air quality standards, renewable energy standards and electric reliability initiatives that impact our utility energy segment.

Common Stock Matters: On December 5, 2013, our Board of Directors authorized a new share repurchase program for up to \$300 million of our common stock from January 1, 2014 through the end of 2017. Funds for the repurchases are expected to come from internally generated funds and working capital supplemented, if required in the short-term, by the sale of commercial paper. The repurchase program does not obligate Wisconsin Energy to acquire any specific number of shares and may be suspended or terminated by the Board of Directors at any time.

In addition, on January 16, 2014, our Board of Directors increased our quarterly common stock dividend to \$0.39 per share, up approximately 2.0%, from \$0.3825 per share.

Investments in Outside Trusts: We use outside trusts to fund our pension and certain other post-retirement obligations. These trusts had investments of approximately \$1.8 billion as of December 31, 2013. These trusts hold investments that are subject to the volatility of the stock market and interest rates.

During 2013, we made no contributions to our qualified pension plans or our qualified Other Post-Retirement Employee Benefit (OPEB) plans. During 2012, we contributed \$95.6 million to our qualified pension plans and \$4.4 million to our qualified OPEB plans. Future contributions to the plans will be dependent upon many factors, including the performance of existing plan assets and long-term discount rates. For additional information, see Note N – Benefits in the Notes to Consolidated Financial Statements.

Off-Balance Sheet Arrangements: We are a party to various financial instruments with off-balance sheet risk as a part of our normal course of business, including financial guarantees and letters of credit which support construction projects, commodity contracts and other payment obligations. We believe that these agreements do not have, and are not reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our investors. For additional information, see Note F – Variable Interest Entities in the Notes to Consolidated Financial Statements in this report.